Supreme Court, U.S.
FILED
FEB 11 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-962

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SOUTHERN UNION COMPANY,
Petitioner,

v.

CONSOLIDATED OIL & GAS, INC.,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of New Mexico

---

REPLY OF PETITIONER SOUTHERN UNION COMPANY

Of Counsel:
THOMAS E. MORTON, JR.
BRUCE E. HENDERSON
SOUTHERN UNION COMPANY
Dallas, Texas

ROBERT H. LOEFFLER *
WILLIAM F. SQUADRON
MARGARET A. FLAHERTY
DINA E. CAPLAN
MORRISON & FOERSTER
2000 Pennsylvania Ave., N.W.
Suite 5500
Washington, D.C. 20006
(202) 887-1500
Counsel for Petitioner Southern Union Company

* Counsel of Record

February 11, 1988

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
INTRODUCTION	1
1. Consolidated's Line Switching Theory Is Not Consistent With the Indisputable Dedication of the Gas to Interstate Commerce and Contrary to Federal Law Governing Dedication and Abandonment	3
2. The New Mexico Court's "Superior Knowledge" Test Conflicts With and Undermines Enforcement of the Federal Scheme of Gas Price Regulation	5
3. This Court May Wish to Hold the Petition Until Appeal of the FERC Order on Which Consolidated Relies Is Complete	8
CONCLUSION	9

TABLE OF AUTHORITIES

CASES Page

California v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965) 3, 4, 5

California v. *Southland Royalty Co.*, 436 U.S. 519 (1978) 3, 4

Consolidated Oil & Gas, Inc. v. *FERC*, 806 F.2d 275 (D.C. Cir. 1986) 3, 5, 6

Gulf Oil Corp. v. *Tenneco, Inc.*, 608 F. Supp. 1493 (D. La. 1985) 8

NAACP v. *Civiletti*, 609 F.2d 514 (D.C. Cir. 1979), *cert. denied*, 447 U.S. 922 (1980) 6

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 (1954) 6

Resources Investment Corp. v. *Enron Corp.*, 669 F. Supp. 1038 (D. Colo. 1987) 8

Southern Union Gathering Co., 28 FERC ¶ 61,225 (1984), *aff'd*, 30 FERC ¶ 61,350 (1985) 3, 5

Transcontinental Gas Pipe Line Corp. v. *State Oil & Gas Board*, 474 U.S. 409 (1986) 4

Universal Resources Corp. v. *Panhandle Eastern Pipe Line Corp.*, 813 F.2d 77 (5th Cir. 1987) 8

STATUTES

The Natural Gas Act of 1938, 15 U.S.C. §§ 717-17z (1982) 5, 6, 7

15 U.S.C. § 717c (1982) 6

The Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-432 (1982) 4, 7, 8

15 U.S.C. § 3314(a)(1) (1982) 7

15 U.S.C. § 3314(b)(6)(B) and (c)(5) (1982) 7

REGULATIONS

18 C.F.R. § 154.91 (1987) 6

18 C.F.R. § 154.92 (1987) 6

OTHER AUTHORITIES

Natural Gas Contracts, Federal Programs Advisory Services, Section 12, pp. 1-17 (November 1987) 8

2A Southland Statutory Construction § 55.03 (4th ed. 1984) 6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-962

SOUTHERN UNION COMPANY,
Petitioner,

v.

CONSOLIDATED OIL & GAS, INC.,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of New Mexico

---

REPLY OF PETITIONER SOUTHERN UNION COMPANY

INTRODUCTION

Southern Union's Petition for Certiorari emphasizes the inherent conflict between Consolidated's duties as a federally regulated natural gas seller and its claim under a state tort theory that it was reasonably ignorant of the regulatory status of four of its natural gas sales contracts. Petition at 18-20. In attempting to refute what it terms the "federal duties" argument, Consolidated's Brief in Opposition ("Oppos.") has introduced new factual arguments. Southern Union's "superior" knowledge of the destination of the gas is said to eliminate Consolidated's duty under federal law to know and conform to the federal price ceilings that govern its ju-

risdictional sales. Oppos. at 18-20. That superior knowledge arises from Southern Union's alleged "power" to switch Consolidated's gas, after purchase, between two parellel pipelines, one destined solely for intrastate commerce and a second jurisdictionally interstate line.[1] Southern Union's Reply is directed solely to the new factual arguments and their penumbra.

The switching argument is a jurisdictional and factual red herring. It is at odds with the reality of the undeniable dedication of Consolidated's gas to interstate commerce and with Supreme Court precedent. Nor can producers' responsibilities under federal law be found to turn upon inherently subjective determinations of who knew the most about regulated gas sales. The proper test should be an objective determination of what a producer is charged with knowing under the law. To permit a natural gas producer's responsibilities under federal law to turn upon a "superior knowledge" test—with the burden of knowledge resting on interstate purchasers—would improperly shift responsibility for regulated producers' conformance to federal law. Such a rule conflicts with the established scheme of federal natural gas price regulation which places the burden of compliance directly on sellers.

---

[1] It is necessary here to distinguish between Southern Union and its then affiliate, Southern Union Gathering Company. Petition, n.1 at ii. The intrastate line was operated by Southern Union Company. The "interstate" line was operated by Southern Union Gathering Company. The four disputed contracts were between Consolidated and Gathering Company. No gas from the four disputed contracts ever flowed in Southern Union's intrastate pipeline as opposed to Southern Union Gathering Company's pipeline. During the first years of those contracts (1958 to 1970), Gathering owned and operated only one line; gas flowing through that line was sold in part to El Paso Natural Gas, an interstate pipeline company, and in part to a New Mexico distribution company, but federal jurisdiction was established over the entire gas stream due to the commingling of the gas flows. *See* 5 *infra*.

1. *Consolidated's Line Switching Theory Is Not Consistent With the Indisputable Dedication of the Gas to Interstate Commerce and Contrary to Federal Law Governing Dedication and Abandonment.*

Consolidated's argument that it could reasonably believe that its gas never flowed through Gathering's jurisdictional line rests upon a finding of the trial court that Southern Union had the "unilateral power" to determine whether the gas would be shipped in interstate commerce and a related argument that Consolidated did not know where or whether it had been so shipped. Oppos. at 18-19. Although the trial court made the cited finding, that factual finding is at odds with the legal conclusion later reached by the New Mexico Supreme Court that the gas from the disputed contracts was dedicated to interstate commerce. Oppos. at 6. That conclusion was inescapable given the finding of the FERC, upheld on review by the U.S. Court of Appeals, that Consolidated's disputed gas was dedicated and subject to federal jurisdiction. *Southern Union Gathering Co.*, 28 FERC ¶ 61,225 (1984), *aff'd*, 30 FERC ¶ 61,350 (1985), *aff'd sub nom. Consolidated Oil & Gas, Inc.* v. *FERC*, 806 F.2d 275 (D.C. Cir. 1986).

The New Mexico trial court finding—upon which the Brief in Opposition heavily relies—cannot be reconciled with the concept of dedication for if the disputed gas were ever so dedicated, it could not leave interstate commerce without prior federal approval, even if the underlying sales contract had expired.[2] The ironclad grip of

---

[2] In specific terms, because Consolidated's gas flowed in Gathering Company's pipeline, the commingling doctrine established in *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965) ("*Lo-Vaca*") resulted in the dedication of the gas that had flowed to interstate commerce, from which it could not be removed, at least through 1978, without prior abandonment authority from the FERC. *California* v. *Southland Royalty Co.*, 436 U.S. 519, 525-27 (1978).

federal jurisdiction upon dedicated gas led to sharply different interstate and intrastate gas markets, and ultimately to the merging of the markets for price regulation in the Natural Gas Policy Act of 1978. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409 (1986). If the gas from the disputed contract was dedicated to interstate commerce, as it undeniably was, when did the *unilateral* power to switch between the two pipelines come into play? It could not exist after dedication consistent with federal law. If Southern Union theoretically had such a choice *before* dedication occurred, that power ceased once dedication had occurred which was years before the settlement was negotiated.

Second, as a matter of paramount federal law, Southern Union's alleged unilateral ability to "switch" gas between its intrastate lines and Gathering's jurisdictionally interstate line could not exist. No reading of *Lo-Vaca* and companion dedication and abandonment precedent suggests that gas could be switched in and out of interstate commerce at the sole discretion of a purchaser subject to federal certificate jurisdiction. Federal control over dedication and abandonment means exactly the opposite. Once committed and dedicated to interstate commerce, gas continued in interstate jurisdiction unless authority to abandon was granted, contract provisions notwithstanding. *California* v. *Southland Royalty Co.*, 436 U.S. at 526. The precedent of this court thus flatly contradicts the trial court's notion of an "on again/off again" dedication to interstate commerce.[3]

---

[3] These same legal principles determined the outcome of Consolidated's claim at FERC and the D.C. Circuit that the geographic destination of its gas could determine its federal jurisdictional status. See discussion at p. 5 *infra*.

2. *The New Mexico Court's "Superior Knowledge" Test Conflicts With and Undermines Enforcement of the Federal Scheme of Gas Price Regulation.*

Consolidated argues that no provision of federal law requires gas producers to do anything more than ask those to whom they make gas sales about the "resale destination" of those sales. Oppos. at 19. On this basis, it contends that Consolidated met its obligations under federal law by making that inquiry of Southern Union.[4]

Natural Gas Act price regulation can arise either from the existence of sales for resale in interstate commerce, or from the commingling of gas involved in such sales with gas destined solely for "intrastate" consumption. Lo-Vaca, 379 U.S. at 369. The New Mexico Court, Appendices to Petition for Writ (App.) at 8a-9a, the FERC, App. at 16a-41a, and the D.C. Circuit, *Consolidated Oil & Gas, Inc.* v. *FERC*, 806 F.2d at 279, all agree that Consolidated's gas sales to Gathering became subject to federal regulation because gas in Gathering's line was so commingled. To continue to argue that destination is relevant when jurisdictional commingling is indisputable is to seek to pretend, contrary to fact, that commingling is not the basis of FERC jurisdiction here. Thus, to argue, as Consolidated does, that its inquiries into the geographic destination of the gas were relevant to the legal issues is to attempt to rewrite the jurisdictional map that this Court established more than thirty years ago.[5]

---

[4] As a factual matter, the record reveals that Consolidated was told before entering into the settlement that gas from the disputed contracts had flowed in a commingled stream and hence in interstate commerce. Defendant's Exhibit (D.E.) 37A, in *Consolidated Oil & Gas, Inc.* v. *Southern Union Co.*, S.F. 79-2161(c).

[5] The United States Court of Appeals tellingly found:

> Consolidated never did deny that its gas had been commingled and some of it sold interstate, as Gathering Company asserts. Consolidated instead argued to the FERC that the sale of the gas in question was not jurisdictional, and now claims that this

Consolidated's contention that "no provision of federal law" applies here is also wrong as a matter of statutory construction. Oppos. at 19. The statutory scheme of price regulation places substantial and specific responsibilities on regulated producers. An underlying prerequisite to performance of those obligations is a duty to know the regulatory status of gas sales. Otherwise, compliance with the statute would be impossible and its purposes could not be effectuated. *See NAACP* v. *Civiletti*, 609 F.2d 514, 516-17 (D.C. Cir. 1979), *cert. denied*, 447 U.S. 922 (1980) (statutory requirements may be inferred by necessary implication from the statutory context); 2A Sutherland Statutory Construction § 55.03 (4th ed. 1984).

Under the NGA, "[a]ll rates and charges made, demanded, or received" were subject to Commission review and approval or modification. 15 U.S.C. § 717c (1982). Under implementing regulations in effect since *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), Consolidated was required to file with the Commission all relevant documents evidencing its interstate sales transactions and the rates charged for such sales. *See* 18 C.F.R. §§ 154.91-154.92 (1987).

There is no dispute that Consolidated conformed to these regulations with respect to its sales to Gathering up to and following the settlement. Prior to 1972, as required, Consolidated filed its contracts and rate schedules for sales to Gathering with the Commission. D.E. 3, 6, 12, and 16. When the Commission increased the ceiling rates for interstate sales, Consolidated asked Gathering to cooperate in its applications to the Commission for its contractually based right to maximum federal

---

argument constituted a denial of Gathering Company's factual assertions about commingling and interstate sale. Consolidated's points regarding the jurisdictional status *vel non* of the sales in question, however, were and are legal ones, not factual ones.

Id. at 279-80 (footnote omitted).

price for those sales. D.E. 17A and 20. After 1972, Consolidated filed applications for small producer blanket certificates with the Commission in which it represented that it made interstate sales of over 5 million MCF and that among those interstate sales were its previously certificated sales to Gathering. D.E. 18.

Enacted in 1978, the NGPA did not relieve Consolidated of its statutory responsibilities. In fact, it specifically places on producers the onus of knowing and conforming to federal law governing interstate sales. Under Section 504 of the Act, it is unlawful for any person "to *sell* natural gas at a *first sale price* in excess of any applicable maximum lawful price under this chapter." 15 U.S.C. § 3314(a)(1) (1982) (emphasis added). The Act provides for civil and criminal penalties for "knowing" violation of its provisions and defines "knowing" as "actual knowledge" or "the constructive knowledge deemed to be possessed by a reasonable individual who acts under similar circumstances." 15 U.S.C. § 3314(b)(6)(B) and (c)(5) (1982).

These NGPA penalty provisions make explicit what is implicit in the NGA—that a determination of what a regulated seller knows is not an inquiry into the seller's state of mind, but rather an objective inquiry into the "constructive" knowledge possessed by a reasonable seller acting under similar circumstances. The relevant "circumstances" must be those consistent with effectuation of the statutory purposes. Thus, under the statute, the relevant inquiry here is whether a reasonable producer acting under similar circumstances, *i.e.*, after fifteen years of representations to the Commission that specific gas sales are federally regulated, would "know" that the sales are federally regulated.

The New Mexico Supreme Court focused instead on Southern Union's alleged superior knowledge of the jurisdictional status of Consolidated's sales resulting from its relative size and sophistication and imposed a "fiduciary

obligation" on Southern Union with respect to its interstate transactions with Consolidated. App. at 11a. In so doing, the New Mexico Court failed to recognize the inherent conflict between what Consolidated had to know as a producer subject to federal price regulation and its claim of inferior knowledge. The missing inquiry was whether Consolidated's purported reliance on a single mistaken representation was reasonable in light of its statutory and regulatory obligations and its representations in filings with the Commission.

3. *This Court May Wish to Hold the Petition Until Appeal of the FERC Order on Which Consolidated Relies Is Complete.*

Apart from the "line switching" argument, Consolidated relies extensively on a FERC Order issued after the New Mexico Supreme Court's final decision to support its Opposition. *See* Oppos. at 9-12 and 15-20. This substantial reliance on an Order which is not before this Court represents an implicit acknowledgment that the legal analysis underlying the New Mexico Court's decision is indefensible.

Apart from the legal errors in the New Mexico decision, this Court should grant the Petition because of the significance of the preemption issues raised in this case —issues which are raised frequently in the context of current litigation between producers and interstate purchasers.[6] Alternatively, in light of Consolidated's reli-

---

[6] There are presently close to two hundred lawsuits by interstate pipeline purchasers and producers in varying stages of litigation. *Natural Gas Contracts*, Federal Programs Advisory Service, Section 12, pp. 1-17 (November 1987). In a number of cases, courts have been directly confronted with questions of whether state court damage awards exceed NGPA ceiling prices. *See, e.g., Universal Resources Corp.* v. *Panhandle Eastern Pipe Line Corp.*, 813 F.2d 77, 80 (5th Cir. 1987); *Resources Investment Corp.* v. *Enron Corp.*, 669 F. Supp. 1038, 1041 (D. Colo. 1987); *Gulf Oil Corp.* v. *Tenneco, Inc.*, 608 F. Supp. 1493, 1497 (D. La. 1985).

ance on the FERC Order, it might also be appropriate for the Court to reserve its decision on this Petition until after the Court of Appeals for the D.C. Circuit has reviewed the FERC Order. If, as is likely, one of the parties petitions for review of the D.C. Circuit's decision, this Court would then have an opportunity to review the case in its entirety.[7]

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

Of Counsel:
THOMAS E. MORTON, JR.
BRUCE E. HENDERSON
SOUTHERN UNION COMPANY
Dallas, Texas

ROBERT H. LOEFFLER *
WILLIAM F. SQUADRON
MARGARET A. FLAHERTY
DINA E. CAPLAN
MORRISON & FOERSTER
2000 Pennsylvania Ave., N.W.
Suite 5500
Washington, D.C. 20006
(202) 887-1500
Counsel for Petitioner Southern Union Company

* Counsel of Record

Dated: February 11, 1988

[7] A decision to await the outcome of the D.C. Circuit's review would not prejudice Consolidated in any way. Southern Union has posted a bond for the full amount of the judgment below and interest continues to accrue, so Consolidated would suffer no injury. A briefing schedule has been established by the D.C. Circuit and oral argument is scheduled for May 31, 1988; the court should render its decision within a reasonable period thereafter, at which time this Court could evaluate more thoroughly the need to review the preemption issues raised by both of these proceedings.